Jemena Gas Networks (NSW) Ltd

2015-20 Access Arrangement Information

Appendix 9.2

Averaging period proposal

Public

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Jemena

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1. PROPOSED AVERAGING PERIOD FOR ESTIMATING THE RISK-FREE RATE AND RETURN ON DEBT FOR THE FIRST YEAR

1.1 PROPOSED AVERAGING PERIOD

1. Jemena Gas Networks (**JGN**) proposes to use the 20 business days from c-i-c to c-i-c (inclusive) (**the averaging period**) as the period to estimate:

   a) the annual return on debt observation for the first year of the next access arrangement (**AA**) period, and

   b) the risk-free rate used to estimate the return of equity for all years of that period.

2. The estimates of these parameters over the averaging period will replace the equivalent estimates included in chapter 9 that were calculated using the market data over a 'placeholder' averaging period (the 20 business days to 12 February 2014).

3. The estimate of the annual return on debt observation for the first year of the next AA period will also replace the placeholder estimate of this parameter that currently appears in square brackets in clause 5.1 of the Proposed AA.

1.2 CONSISTENCY WITH THE RATE OF RETURN GUIDELINE

4. The proposed averaging period is consistent with guidance in the rate of return guideline (**rate of return guideline**) because it:[1]

- falls prior to the commencement of JGN's next regulatory control period
- falls as close as practical to the start of the first year of this period (i.e. 1 July 2015)
- occurs after the date of JGN's 2015 AA proposal (i.e. after 30 June 2014).

5. We also propose using the same averaging period for both the return on debt and return on equity, consistent with rule 87(5)(b):

   - *In determining the allowed rate of return, regard must be had to:*
   - *…*
   - *the desirability of using an approach that leads to the consistent application of any estimates of financial parameters that are relevant to the estimates of, and that are common to, the return on equity and the return on debt.*

[1] AER, *Better Regulation Rate of return guideline*, December 2013, pp. 21–22.

1.3 CONFIDENTIALITY

6. Consistent with the rate of return guideline and previous regulatory practice, we propose keeping the averaging period confidential until after it has passed. This gives JGN an opportunity to align its actual funding costs with the allowed rate of return estimated over this period without the risk of other market participants using this information against our legitimate commercial interests.

2. AVERAGING PERIODS TO BE USED FOR CALCULATING THE RETURN ON DEBT FOR LATER YEARS

2.1 IMPLEMENTING THE TRAILING AVERAGE APPROACH

7. As discussed in appendix 9.10, JGN proposes applying a trailing average method to calculate the return on debt. Under this method, the return on debt is updated for each year of the next AA period, in accordance with a trailing average formula. The trailing average methodology proposed by JGN is consistent with the rate of return guideline.[2]

8. In order for the trailing average formula to update throughout the next AA period, an annual return on debt observation is needed for each year. This requires averaging periods to be first nominated and then used to calculate the annual return on debt observation for each year.

9. Section 1 sets out the averaging period that JGN proposes for calculating the annual return on debt observation for the first year of the next AA period (i.e. the first averaging period).

2.2 PROCESS FOR NOMINATING FUTURE AVERAGING PERIODS

10. For each subsequent year of the next AA period, the proposed AA sets out a process for nominating and the AER approving) an averaging period for calculating the annual return on debt observation.

11. Once the averaging period is nominated and approved as per the process set out in the proposed AA, the process for calculating the annual return on debt observation is applied automatically and the trailing average return on debt formula is updated. These processes are described in more detail in appendix 9.10 and are codified in clause 5 of the proposed AA.

12. The process for nominating averaging periods set out in the proposed AA provides that (among other things):

    a) the averaging period used for calculating the annual return on debt observation for each of the later years of the next AA period (i.e. all years other than the first year) must be nominated by JGN at least 50 business days prior to the start of the financial year in which it is to occur, and

    b) the nominated averaging period must be a period of at least 10 consecutive business days, falling entirely within the financial year immediately prior to the financial year for which it is to be used to calculate the annual return on debt observation.

2.3 NOMINATING THE SECOND AVERAGING PERIOD

13. This process implies that the averaging period used to calculate the annual return on debt observation for the second year of the next AA period (financial year 2016/17) must fall entirely within the first year of the next AA period (financial year 2015/16) and JGN must nominate this period at least 50 business days prior to the start of the first year (i.e. no later than 21 April 2015).

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2 AER, *Better Regulation: Rate of return guideline*, December 2013, pp. 19–20.

14. The proposed AA is unlikely to be approved in time to allow for nominating and approving an averaging period for calculating the annual return on debt observation for the second year of the next AA period as per the process set out therein. However, JGN proposes following this process to nominate an averaging period to fall in financial year 2015/16, even if the proposed AA is not approved in time for the start of this process.

15. As per the process set out in the proposed AA, JGN will nominate an averaging period to fall in financial year 2015/16—for calculating the annual return on debt observation for the second year of the next AA period—no later than 21 April 2015. JGN intends to nominate at the same time as it provides its response to the AER's draft decision.

2.4 NOMINATING THE THIRD AND SUBSEQUENT AVERAGING PERIODS

16. JGN will nominate averaging periods to fall in financial years 2016/17, 2017/18 and 2018/19, and subject to AER approval, as per the process set out in clause 5 of the AA. JGN will use these averaging periods (once approved) to calculate the annual return on debt observations for financial years 2017/18, 2018/19 and 2019/20 respectively—which we will in turn use to update the trailing average return on debt formula.

17. Appendix 9.10 further explains our proposed nomination process and our reasons for this.